

# Rent Seeking Opportunities and Economic Growth in Transitional Economies

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# Motivation

- Assessing Neoclassical growth model predictions
  - Economic convergence
    - such catching up is not yet complete and, for some countries, may seem to have not yet started.
- Why these nations fail to grow?
  - Rent seeking
- We focus in particular upon
  - “middle income” countries, which are typically launched upon a process of economic development but still in a transitional phase
    - considerable heterogeneity in opportunities for rent seeking activity (RSA)

# Objective

- An empirical assessment of the overall macroeconomic consequences of institutional frameworks that offer opportunities for RSA
  - Offers evidence for / against neoclassical growth model
  - Examines particular aspects of transition economies
  - Provides policy-relevant conclusions

# Conceptual Framework

- Rent-seeking (RS) is defined as earning income without being productive (Tullock, 1967)
- Tollison (1982) observes that RSA can also consist of the allocation of scarce resources so as to create and benefit from economically inefficient transactions
- Fischer (2006) asserts that RSA is “usually implying the expenditure of scarce resources, to cause and capture artificially-created rents as well as transfers which are not part of society's intended income redistribution
- For this present study, RSA is envisaged as
  - any activity through which public power is exercised for private gain; this may involve misuse of public resources or, more generally, any attempted capture of the state’s authority by politicians, public officials, elites and private interests.

# Conceptual Framework(2)

- North (1990) argues that the institutional framework is crucial and often provides room for RSA, especially in developing countries
- Institutional frameworks that are weak can create opportunities for RS such as
  - ineffective or partial rule of law,
  - absent or ill-defined property rights and
  - limitations on the extent to which democratic processes exercise authority over key institutions.
  - Such institutional weaknesses provide room for, *inter alia*, misuse of resources, violations of regulations, restrictions of trade, thus motivating RSA

# Literature Review: Empirical

- Few studies investigate the growth effects of RSA.
  - The outcome remains inconclusive
    - Few show negative relationship between (see e.g. Laband and Sophocleus, 1988; Brumm, 1999; Cole and Chawdhry, 2002)
    - while others concludes positive relationship (see e.g. Mork, 1993; Gray and Lowery, 1996) between rent seeking and economic growth
- Even fewer look at international comparisons
  - Many are USA – based, where data is more readily available

# Rent seeking measures

- Political environment
  - Institutional Democracy
    - measured by competitiveness of political participation, competitiveness of executive recruitment, openness of executive recruitment and constraints on the chief executive
- Regulatory environment
  - Control of corruption
    - Measures the extent to which public power is exercised for private gain, including petty and grand forms of corruption, as well as “capture” of the state by elites and private interest
  - Freedom from corruption
    - measures the perceived level of corruption as it affects a country’s economic freedom by introducing insecurity and uncertainty

# Data

- Panel data set of 52 “middle income” countries over the period 1986-2010
- Variables
  - Institutional Democracy (0-10)
  - Control of corruption (-2.5-+2.5)
  - Freedom from corruption (0-100)
  - Physical capital (Investment/GDP)
  - Human capital (Education & Health)
  - GDP per capita at constant prices



# Modelling Framework

- The modelling framework is a
  - Mankiw-Romer-Weil (MRW) conditional convergence model augmented by measures of the opportunities for RSA

$$\Delta Y_{it} = \alpha + \beta Y_{i,t-1} + \gamma \Delta Y_{i,t-1} + \delta_{PC} PC_{it} + \delta_{HC} HC_{it} + \rho R_{it} + u_i + \varepsilon_{it}$$

# Estimation Methodology

- Econometric modelling
  - “system-GMM”
    - OLS inconsistent in panels
    - Classical panel estimators inconsistent for dynamic models
    - Estimating in first differences (Arellano-Bond) weak when x-sectional heterogeneity is strong
    - System-GMM estimates in levels AND differences

# Results (1)

## Validity of the basic modelling framework

Variables	(1)	(2)	(3)
GDPPC growth (-1)	0.249 (0.06)***	0.241 (0.06)***	0.245 (0.06)***
GDPPC(-1)	-0.002 (0.00)***	-0.002 (0.00)***	-0.003 (0.00)***
Physical Capital	0.145 (0.06)**	0.128 (0.06)**	0.134 (0.06)**
HC (education)	21.389 (6.21)***		9.869 (9.24)
HC (health)		32.519 (8.34)***	24.974 (11.49)**
Constant	-7.842 (2.69)***	-18.774 (5.69)***	-18.215 (5.57)***
Observations	1,248	1,248	1,248
Number of Countries	52	52	52

Robust standard errors in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

# Results (2)

## Rent seeking opportunities and economic growth

Variables	(1)	(2)	(3)	(4)	(5)
GDPPC growth (-1)	0.238 (0.06)***	0.144 (0.07)**	0.148 (0.07)**	0.147 (0.07)**	0.152 (0.07)**
GDPPC(-1)	-0.002 (0.00)***	-0.002 (0.00)***	-0.002 (0.00)***	-0.002 (0.00)***	-0.002 (0.00)***
Physical Capital	0.134 (0.06)**	0.116 (0.07)*	0.126 (0.07)*	0.118 (0.07)*	0.118 (0.07)*
HC (health)	27.421 (8.19)***	36.761 (8.47)***	36.124 (8.18)***	32.085 (8.93)***	31.072 (8.63)***
Democracy	0.431 (0.16)***			0.332 (0.17)**	0.362 (0.17)**
Control of corruption		0.067 (0.05)		0.065 (0.06)	
Freedom from corruption			0.444 (0.25)*		0.484 (0.26)*
Constant	-17.417 (5.34)***	-22.533 (6.52)***	-23.262 (6.40)***	-20.892 (6.51)***	-21.646 (6.42)***
Observations	1,248	780	780	780	780
Number of Countries	52	52	52	52	52

Robust standard errors in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

# Results (3)

## Corruption control and level of democracy

Variables	Weak democracy		Strong democracy	
	(1)	(2)	(3)	(4)
GDPPC growth (-1)	0.201 (0.15)	0.200 (0.15)	0.127 (0.05)**	0.120 (0.06)**
GDPPC(-1)	-0.001 (0.00)***	-0.001 (0.00)**	-0.001 (0.00)**	-0.001 (0.00)***
Physical Capital	-0.018 (0.08)	-0.027 (0.08)	0.189 (0.06)***	0.195 (0.07)***
HC (Health)	23.941 (9.84)**	23.454 (9.71)**	28.144 (14.39)*	22.832 (13.33)*
Control of corruption	0.026 (0.08)		0.070 (0.04)*	
Freedom from corruption		-0.236 (0.31)		0.555 (0.33)*
Constant	-11.603 (7.60)	-10.301 (7.61)	-20.809 (10.94)*	-15.041 (12.69)
Observations	330	330	450	450
Number of Countries	22	22	30	30

Robust standard errors in parentheses

\*\*\* p<0.01, \*\* p<0.05, \* p<0.1

# Summary

- In a panel of 52 transitional economies:
  - The basic MRW “conditional convergence” model is empirically supported, but with health, rather than education, as the preferred indicator of human capital enhancement
  - Path dependency exists
  - Strength of democracy is a statistically significant addition to the basic model but extent of perceived corruption is not so
- In separate panels of “weakly democratic” (WD) and “strongly democratic” (SD) countries
  - (slow) convergence is evident in both groups
  - path dependence is present only in SD
  - rate of physical capital formation influences growth rates only in SD
  - extent of corruption influences growth rates only in SD

# Summary (2)

- Democracy enhances economic transition (by reducing opportunities for RSA?)
- When democracy is strong then reducing corruption will further improve growth
- Health seems more important than education for speed of transition
- Growth is relatively fragile in WD countries – shocks are not smoothed by path dependency and investment has no immediate impact

# Policy Implication

- Governance institutions which are not overtly “economic” in their focus may nevertheless be integral to economic development
- Democracy in and of itself is associated with more sustainable economic development for transition economies and additionally
- Within the more democratic countries, a reduced incidence of (perceived) corruption is associated with faster growth



Thank you for listening